

must consider the effects of phased development on the Tribe's social, economic and cultural well-being, the air quality of the Northern Cheyenne Reservation, surface water quality, groundwater and methane migration, methane drainage, wildlife resources, and the Tribe's cultural resources. Because this evaluation of impacts involves many areas of unique tribal expertise and knowledge, it should be undertaken in close consultation with the Tribe.



2550 M Street, NW
Washington, DC 20037-1350
202-457-6000

Facsimile 202-457-6315
www.pattonbogggs.com

John C. Martin
(202) 457-6032
jmartin@pattonbogggs.com

September 6, 2005

Bureau of Land Management
Attn: Mary Bloom, SEIS/Amendment Comments
111 Garryowen Road
Miles City, MT 56301

Re: **Comments on BLM's Notice of Intent to Prepare a Supplement to the Montana Statewide Oil and Gas Final Environmental Impact Statement, 70 Fed. Reg. 45417 (August 5, 2005)**

Dear Sir or Madam:

These comments on the BLM's Notice of Intent to Prepare a Supplement to the Montana Statewide Oil and Gas Final Environmental Impact Statement, 70 Fed. Reg. 45417 (August 5, 2005), are submitted on behalf of Pinnacle Gas Resources, Inc. ("Pinnacle"), Anadarko Petroleum Corporation, and Devon Energy Corporation (collectively "Lessees").

LESSEES' INTERESTS IN THESE ISSUES

The Lessees have concrete interests in these issues. Lessees Pinnacle and Anadarko each hold federal, state, and private leases in the Montana portion of the Powder River Basin area that was addressed in the January 2003 Montana Statewide Oil and Gas Final Environmental Impact Statement ("FEIS") and April 2003 Record of Decision ("ROD"). Lessee Devon owns numerous federal, state and private leases in other areas potentially affected by BLM's actions in the Powder River Basin. Collectively, the Lessees have invested millions of dollars in coalbed methane development in Montana. The FEIS and ROD approved the development of coalbed methane on federal leaseholdings within the Powder River Basin.

In May 2003, shortly after these National Environmental Policy Act ("NEPA") documents were finalized, the Northern Cheyenne Tribe and Native Action (collectively "Tribe") and the Northern Plains Resource Council ("NPRC") filed separate lawsuits. These lawsuits made claims under NEPA, the National Historic Preservation Act ("NHPA"), and the Federal Land Policy and Management Act ("FLPMA"). Early in the case, the Lessees filed motions to intervene as Defendants. Neither the Government nor the Plaintiffs opposed these motions and the District Court granted intervention on July 10, 2003. Since that time, the Lessees have been actively involved in the defense of the Bureau of Land Management's ("BLM") FEIS and ROD. At the



Bureau of Land Management
September 6, 2005
Page 2

District Court level, Lessees participated in the summary judgment briefing in which they sided with the government, defending BLM's decision making and full compliance with NEPA and the other laws at issue.

In its February 25, 2005 order, the District Court held that the FEIS complied with NEPA with one exception: BLM should have considered in detail a phased development alternative. In an "advisory opinion" that was not part of its ultimate decision, the court suggested two additional areas of focus: the cumulative impacts of the Tongue River Railroad, and the private water well mitigation agreements. February 25, 2005 Order of Judge Anderson in consolidated cases of *Northern Plains Resource Council v. BLM* (CV-03-69-BLG-RWA) and *Northern Cheyenne Tribe et al. v. Norton* (CV-03-78-BLG-RWA) at 27. The District Court rejected the Plaintiffs' FLPMA and NHPA claims. *Id.* at 29-32. The District Court remanded to BLM, ordering it to conduct a detailed analysis of phased development as a "reasonable alternative" and to issue a Supplemental EIS. April 5, 2005 Order of Judge Anderson in consolidated cases of *Northern Plains Resource Council v. BLM* (CV-03-69-BLG-RWA) and *Northern Cheyenne Tribe et al. v. Norton* (CV-03-78-BLG-RWA) at 9. (These issues are currently on appeal to the Ninth Circuit.)

Given its holding that BLM violated NEPA, the District Court held an evidentiary hearing on the appropriate scope of injunctive relief. In light of the District Court's order, BLM proposed a tailored injunction that responded to the court's February 25, 2005 order. BLM's proposal allowed a limited number of coalbed methane wells (*i.e.*, 500 new federal, state, and private wells per year) in a carefully-defined geographic area covering just seven percent of the total 4.1 million acre area for coalbed methane development. April 5 Order at 4. BLM's approach also imposed a number of additional protective conditions. *Id.* at 9-11. Based on that hearing, the court issued an order on April 5, 2005 that adopted BLM's proposal, calling it "a balanced, equitable approach to CBM development during the pendency of the SEIS." *Id.* at 5.

Because the Lessees did not agree with the District Court's finding of a NEPA violation, they—as well as the government—filed Notices of Appeal with the Ninth Circuit. Plaintiffs sought an emergency blanket injunction from the Ninth Circuit to bar all future development while the case was on appeal; the Ninth Circuit granted this injunction and development on federal leases in Montana is currently at a standstill. Lessees have pursued their cross-appeal before the Ninth Circuit, arguing that the District Court erred when it concluded that BLM's rejection of phased development violated NEPA and that the court overstepped its boundaries when it ordered BLM to conduct a SEIS. Although the Government filed a Notice of Appeal, it subsequently declined to pursue its cross-appeal. It is, however, the Lessees' understanding that BLM continues to believe that it did not violate NEPA, and that, if the Ninth Circuit reversed the District Court's ruling, BLM may determine that phased development does not warrant detailed analysis, making

a SEIS unnecessary. Briefing before the Ninth Circuit is completed and oral argument is scheduled for September 15, 2005.

LESSEES' COMMENTS ON THE NOTICE OF INTENT

In light of the District Court's opinion and the current procedural posture of this case, Lessees agree that it is appropriate for BLM to evaluate the issues set forth in its August 5, 2005 Notice of Intent. However, if the Ninth Circuit reverses the District Court's ruling and finds that BLM complied with NEPA, Lessees anticipate urging BLM not to prepare a detailed analysis of a phased development alternative. If the Court rules in Lessees' favor on this issue, BLM would be free to employ its discretion to determine whether a SEIS would be warranted and, if it is, whether a phased development alternative should be considered in detail. In our view, analysis of a "phased development" alternative is a futile effort; the alternative is not "reasonable" for a number of sound policy reasons. Should the Court of Appeals reverse the lower court, BLM could either implement the Resource Management Plan without further NEPA review or, depending on the nature of the decision, provide a more detailed explanation of why phased development is not a reasonable alternative. If minor revisions to the EIS are necessary, those revisions could be completed in a much shorter time than the projected time for completing a SEIS. (Currently, BLM projects a completion date of December 2006, which will mean that Lessees will forego yet another entire drilling season.)

Alternatively, assuming that the District Court's decision stands, the Lessees submit the following comments.

1. Definition of Phased Development

In the FEIS, BLM defined three types of phased development: controlling the number of rigs, limiting coalbed methane development to one geographic area at a time, or creating wildlife corridors. FEIS at 2-4. These were the same three types of phased development identified by the District Court. In this SEIS process, BLM is not obligated to look to new and different types of phased development beyond those in the FEIS, the District Court opinion, and the comments BLM received in the protests of the FEIS.

Plaintiffs have changed their proposed definitions of phased development and full-field development during this litigation. Before the Ninth Circuit, Plaintiffs recently claimed that full development is "development which seeks to extract all of the CBM from a delineated field." This definition seems to suggest that development can only be phased when the developer intentionally leaves some portion of the resource in the ground. This simply makes no sense. Their briefing before the Ninth Circuit also seems to argue that phased development requires

production to advance in phases within individual fields. This novel definition of phasing was not raised before the agency during the comment period on the FEIS. *Public Citizen v. U.S. Dep't of Transp.*, 541 U.S. 752, 764-65 (2004). BLM may wish to determine whether additional definitions of phased development beyond the three set forth in the FEIS warrant additional review in the SEIS process. Lessees believe, however, that irrespective of what definition BLM examines, any type of phased development is not reasonable and not feasible.

Moreover, Lessees have made clear that much of the development that has already occurred in Montana occurs in a phased manner. Practical constraints, such as technology, available capital, infrastructure, and state and federal permitting requirements all dictate that industry's proposed development occurs in phases. Moreover, BLM's staffing limitations delay its ability to process Plans of Development ("PODs"). In addition, BLM cannot control where and when development occurs because it is the lessees who submit PODs and who make decisions about how development is staged. BLM simply responds to their proposals. As such, phasing is more appropriately raised in the context of an individual POD, not at this programmatic level.

2. "Phased Development" Is Not a Reasonable Alternative

Despite the District Court's ruling, any definition of "phased" development is unlikely to be a reasonable or feasible method of developing coalbed methane in Montana. Specifically, the federal, state, and private fee lands are interspersed within the Montana portion of the Powder River Basin. This resulting checkerboard pattern of land ownership imposes a number of serious constraints on almost any proposed definition of "phased development." The pattern of land ownership means that, under any "phased" approach within the Powder River Basin, many state and private leases will inevitably be developed *before* the federal leases. There are at least four significant impediments to phasing development: (a) drainage of federal resources, (b) greater environmental impacts, (c) economic losses, and (d) violations of Lessees' property and contract rights. Each of these is discussed in more detail below.

a. Drainage of federal resources

BLM's FEIS emphasized the problem posed by drainage of federal resources from offsetting state and private wells. FEIS at 1-19. As BLM noted in its FEIS, it is the "conservator" of the methane resource on federal lands and it has a duty to prevent waste and ensure development. FEIS at 1-6. BLM has the "prime responsibility" and "legal obligation" to protect the U.S. government from loss of royalty as a result of oil and gas drainage. FEIS at 1-7, 2-4. In the FEIS, BLM also acknowledged that, given the checkerboard pattern of lease holdings, production on state leases "could compromise BLM's legal obligation to protect federal minerals." FEIS at 2-4.

A briefing document drafted by the BLM Directors of Montana and Wyoming focused on the problem of drainage. It noted that “[t]he rapid, widely dispersed development of non-federal CBM” means any attempt to phase development would not be “viable” or “feasible” because it would result in significant, additional drainage. *See* Attachment A, June 26, 2002 Briefing Document to Director from Wyoming and Montana State BLM Directors (document is part of the administrative record in the two other NEPA challenges to the Montana EIS). After analyzing the issue thoroughly, the Directors’ briefing concludes that “phased development of CBM is not feasible.”

Phased development is inconsistent with the Mineral Leasing Act’s requirements that federally-leased lands obtain the maximum ultimate economic recovery of oil and gas and that the leases must be diligently developed to protect against drainage. *See* Attachment A. However, BLM has few options to limit or prevent drainage in the Montana Powder River Basin. There are regulations that require federal lessees to (a) *seek* agreements with draining state or fee operators to share their proceeds, 43 C.F.R. § 3162.2-4(b) or to (b) *seek* compensation from draining parties, 43 C.F.R. § 3162.2-2(b). However, there are no mechanisms that require an adjacent landowner to participate in such agreements, nor do they have any incentive to do so. *See* Attachment A. We understand that BLM’s experience in Wyoming demonstrates that drainage can be a costly phenomenon and, in most instances, BLM is unable to prevent its loss without authorizing production from federal leases.

Nor could a phased development alternative accommodate drainage concerns. Obviously, BLM is in no position to anticipate future development on private or even state property. Drainage concerns will arise depending on where future development will occur. One would expect that BLM would want the flexibility to adapt to future development and to consider drainage in processing future applications to drill.

To the extent phased development is adopted, or even considered in detail in BLM’s SEIS, BLM must then acknowledge that state and private leases adjacent to federal leases are likely to significantly drain the federal resources. This is a significant problem for Lessees, whose leases become devalued, and for the county, state, and federal governments, who collect decreased royalties and production taxes. *See* Attachment A. This is not some theoretical possibility. Already, development on adjacent private lands in Montana are draining Pinnacle’s federal leases. *See* Attachment B, August 12, 2005 Declaration of Peter G. Schoonmaker, Pinnacle Gas Resources, Inc., which is part of the record before the Ninth Circuit. This trend is likely to continue. *See* Attachment C, March 23, 2005 Declaration of David Breish, BLM Mineral Resource Specialist, Miles City Field Office.

b. Greater environmental impacts

Phased development will mean that, in the Powder River Basin, development cannot proceed in contiguous geographic areas but instead state and fee leases will be developed *before* federal leases. This will inevitably result in significant environmental harm that would not otherwise occur. For example, Pinnacle has already submitted two PODs—Coal Creek and Dietz—to develop some of its state and fee leases. Because the federal leases cannot be included, Pinnacle must employ 80-acre spacing in these PODs. These two PODs are good previews of what will likely happen if phased development is adopted project-wide.

The necessary adoption of 80-acre spacing instead of 160-acre spacing translates into nearly twice the number of wells, roads, infrastructure, surface disruption, and produced water. It will also result in nearly twice the construction-related disturbances. Multiple mobilizations of workers and equipment will be necessary: first, a right-of-way corridor will be established to service the state and fee wells, and later these rights-of-way will be expanded and augmented to service the federal wells. Multiple mobilizations will result in additional risk to wildlife and additional air quality impacts. Multiple mobilizations and longer development times are particularly disruptive to surface owners because they create more environmental and aesthetic harms. These landowners want the work to be completed as quickly as possible. For additional information on these environmental harms, *see* Attachment B.

c. Economic and job losses

Lessees will suffer significant financial harm as a result of phased development, which will needlessly delay the development of coalbed methane on federal leases. Pinnacle, for example, has estimated that a nine-month delay in its coalbed methane development reduces the net present value of its cash flow by \$7.1 million dollars. A nine-month delay in Pinnacle’s development would cost the community a direct loss of approximately 10 jobs and an indirect loss of approximately 80 vendor/contractor jobs. These jobs may be lost completely, or simply deferred for a year. Either way, there will be an associated net present value decrease in the collections of federal income taxes, state income taxes, and state payroll taxes.

In addition, the harm to industry ripples through to the federal, state, and county governments who receive production taxes and royalties. Pinnacle estimates that the lost production taxes for a nine-month delay are \$524,000 to the state and \$429,000 to the county. Pinnacle estimates that the lost royalties for a nine-month delay are \$1.4 million to the state and \$1.4 million to the federal government. For additional information on these economic costs, *see* Attachment D, June 21, 2005 Declaration of Peter G. Schoonmaker, which is part of the record before the Ninth Circuit.



Bureau of Land Management
September 6, 2005
Page 7

d. Violation of Lessees' contract and property rights

BLM acknowledged in its FEIS that the Lessees have an expectation that their "applications for permits to drill will be *considered* in a timely manner and approved *absent unacceptable site-specific impacts*." FEIS at 2-4 (emphasis added). That obviously does not mean that Lessees have an absolute right to develop, or that BLM has already made an irreversible and irretrievable commitment of coalbed methane resources. Instead, Lessees have an expectation of timely review.

A delay in obtaining such review may mature into a breach of contract action. See *Mobil Oil Exploration & Producing Southeast, Inc. v. United States*, 530 U.S. 604, 620-21 (2000) (lessees have an opportunity to develop, not a guarantee of development). If, however, BLM's decision to phase development resulted in a delayed consideration of applications, that could mature into a contract violation. In addition, during any delay in development, Lessees' federal leases will be drained, which devalues their property and contract rights, and they will be arbitrarily subjected to disparate treatment based on a phased plan. Phased development could also increase the risk of a taking if the PODs submitted by Lessees are not approved by BLM because their lease is in the wrong "phase" or location. See Attachment A. Lessees would have a legitimate claim to compensation for losses sustained as a result of a policy that unnecessarily gives rise to drainage.

3. Use of Private Water Well Mitigation Agreements

Lessees believe that BLM's incorporation of private water well mitigation agreements was entirely reasonable, and the court's "advisory opinion" does not appear to challenge their use. Instead, the court asked BLM to further explain and clarify how the water well mitigation agreements will work. Lessees do not object to such a clarification.

4. Consideration of the Cumulative Impacts of the Tongue River Railroad

Lessees note that it was perfectly reasonable at the time the FEIS was prepared for BLM to disregard any potential cumulative impacts of the Tongue River Railroad. During the planning and drafting stages of the FEIS, it was not reasonably foreseeable that the Tongue River Railroad would be built. The Western Alignment portion of the Tongue River Railroad, which travels through Rosebud and Big Horn Counties, has proceeded on a start and stop basis, making it unclear if and when the railroad would actually be constructed. For example, the environmental work for the NEPA analysis for the Tongue River Railroad was actually suspended for almost three years, from March 2000 until December 2002. See 68 Fed. Reg. 50829, 50830 (Aug. 22, 2003). That suspension occurred during a critical time in the planning and development of the 2003 NEPA documents for Montana coalbed methane development. It was not until March 26,



Bureau of Land Management
September 6, 2005
Page 8

2003—after the completion of the FEIS at issue here—when a Notice of Intent indicated that the Tongue River application would indeed go forward and that comments were requested on a 1999 SEIS. See 68 Fed. Reg. at 50830.

Given this timing, it makes sense that the Tongue River Railroad was excluded from the Montana coalbed methane FEIS. See, e.g., *Norton v. Southern Utah Wilderness Alliance*, 124 S. Ct. 2372, 2384-85 (2004) (noting once land use plan is approved, there is no ongoing action that required supplementation when new information arises).

Instead, it was more appropriate for the Tongue River Railroad NEPA documents to consider the cumulative effects of Montana coalbed methane development, as they planned to do. See 68 Fed. Reg. at 50833 (noting cumulative impacts of the construction and operation of the entire railroad line will include "BLM's recently approved management plan relating to the development of coal bed methane wells"). It would also make sense for future coalbed methane PODs in the vicinity of the railroad to consider the effects of the railroad.

Since the Montana FEIS was published in early 2003 the Tongue River Railroad project has become much more likely. A Draft EIS for the project was published in October 2004. To the extent that BLM may wish to consider the cumulative impacts of the Tongue River Railroad, Lessees do not object, even though they believe such a review is not required.

Sincerely,


John C. Martin

Enclosures



Bureau of Land Management
September 6, 2005
Page 9

List of Attachments	
Document	Designation
Briefing Document to Director from Wyoming and Montana State BLM Directors, June 26, 2002	A
Declaration of Peter G. Schoonmaker, Pinnacle Gas Resources, Inc., August 12, 2005	B
Declaration of David Breish, BLM Mineral Resource Specialist, Miles City Field Office, March 23, 2005	C
Declaration of Peter G. Schoonmaker, Pinnacle Gas Resources, Inc., June 21, 2005	D

Tab A

DRAFT**DATE:** June 26, 2002**BRIEFING FOR THE DIRECTOR****PREPARED BY:** Alan Rabinoff, BLM Deputy State Director, Minerals and Lands, Wyoming**FROM:** Al Pierson, State Director, Wyoming and Sherry Barnett, Acting State Director, Montana**SUBJECT:** Phased and Clustered Development of Coalbed Methane (CBM) in the Powder River Basin**PURPOSE OF BRIEFING DOCUMENT:** To inform readers of issues concerning phased and clustered CBM development in the Powder River Basin, Wyoming and Montana

ISSUES: Public comments received on Wyoming's Powder River Basin Oil and Gas DEIS and the Montana Statewide Oil and Gas EIS and Amendment of the Powder River and Billings RMPs include the call for phased and/or clustered development of CBM. One concept for such development is to allow production in one geographic area at a time, then move on to another area. A separate comment asked that BLM phase development in such a way as to leave corridors of undeveloped areas to enable wildlife migration. Phased-in development, as suggested by the Northern Plains Resource Council in their comment letter, refers to developing one coal seam at a time. Clustered development would require that CBM operators cluster pipelines and access roads together and bury power lines within existing rights-of-way. It was suggested by one comment that flow lines to compressor stations should be shared by different operators in order to reduce surface disturbance and development costs. BLM Wyoming and Montana believe that such manner of development should not and cannot be implemented as proposed by the public comments.

MAIN DECISION OR MESSAGE: Phased development of CBM in the Powder River Basin is not a viable option for several reasons as outlined below. In the alternative, some form of agreement would have to be reached between BLM, the state and private lessees and Federal (various agencies), State and private surface owners in order to achieve phased development. This would be difficult, if not impossible, to accomplish, since it could require BLM to direct or control development on private, state and federal leases. This would be an infringement on contracts (leases) between state and private mineral owners and their lessees. The oil and gas regulations do not allow BLM such control. The use of adaptive management techniques while monitoring effects will allow full-field development in an environmentally sound manner while contributing to the Nation's supply of clean-burning natural gas.

BUREAU PERSPECTIVE: The mixed land-ownership pattern in the Powder River Basin contains both private surface and private oil and gas interspersed with federal and state mineral estate. Most federal oil and gas underlies private surface. About half of the oil and gas rights in the area are privately owned. The State of Wyoming's Oil and Gas Conservation Commission (WYOGCC) has already approved approximately 13,500 applications for permit to drill (APDs). Approximately 75% of these APDs have been for non-federal wells. The WYOGCC has stated that they must approve an APD that is technically and administratively complete. The State of Montana is complying with an agreement to complete a MEPA/NEPA process before issuing any further permits. When the State issues a MEPA document that allows them to begin permitting, they will begin to approve wells on private minerals immediately (see Attachment 1 from the State of Montana)

The rapid, widely dispersed development of non-federal CBM has resulted in significant drainage of federal lands. The BLM Buffalo Field Office is currently only approving APDs to reduce the ongoing drainage of federal CBM. NEPA limitations currently limit them to approval of approximately 600 additional APDs. The Miles City Field Office can only approve the drilling and testing (no production) of a limited number of CBM wells at this time. Drainage of federal leases may start in the near future where private and state wells have been drilled and are producing.

WY BLM AR for PRB EIS CD#7 of 20 15361

Any attempt by BLM to phase the development of CBM resources in the Powder River Basin would result in additional drainage of federal CBM, while private and state leases continued to be drilled and produced. This would reduce the value of federal leases in Wyoming and Montana as well as reduce royalties received by the federal- and state governments. With the mix of land ownership, the existence of private, state and federal leases, as well as the continuing approvals of APDs by the WYOGCC, phased development of CBM is not feasible.

Phased development would run counter to the current BLM coal/CBM conflict policy, which encourages CBM operators to develop and produce the CBM resource before coal mining reaches their oil and gas leases.

Phased development could also increase the risk of "takings" in several ways including: 1. Oil and gas operators who have APDs submitted ahead of others but must wait because their lease is in the "wrong" phase (location); 2. Oil and gas operators who have all necessary state approvals and a technically and administratively complete APD submitted to BLM, but their lease is in the wrong phase; and 3. Oil and gas operators whose federal leases are being drained but these leases are just across the "line" of a "phased area" to be left undeveloped for perhaps several years.

The Mineral Leasing Act and 43 CFR 3100 require maximum ultimate economic recovery of oil and gas from leased lands. In addition, 43 CFR 3162 requires the diligent development of leases to protect the federal government from suffering loss through drainage. In light of the broad geographic distribution of leases in the Powder River Basin, phased development would not allow compliance with the above requirements.

CONTACTS: Al Pierson, Wyoming State Director, 307-775-6001; Sherry Barnett, Acting Montana State Director, 406-896-5012; Alan Rabinoff, Wyoming Deputy State Director, Minerals and Lands, 307-775-6148; or Tom Lonnie, Montana Deputy State Director, Resources, 406-896-5003

WY BLM AR for PRB EIS CD#7 of 20 15362

ATTACHMENT I

State of Montana

82-11-173. Legislative findings -- purpose.

(1) The legislature finds that a delay in the development of certain coal bed methane wells may inadvertently result in the loss of coal bed methane resources.

(2) The legislature further finds that because of the nature of this subsurface mineral resource, it is highly susceptible to collateral extraction and use through development efforts on adjacent federal, tribal, or other states' lands to the economic detriment of Montana and its citizens.

(3) The legislature further finds that there is a compelling state interest to authorize the board through this limited program to act in a timely and expeditious manner to permit coal bed methane wells to offset the collateral permitting of wells by other entities on nonjurisdictional lands that are not subject to permitting by the board under 82-11-103 in order to:

- (a) protect coal bed methane mineral reserves from collateral extraction by others;
- (b) provide economic benefits to the state;
- (c) protect the private property rights of the owners of the mineral reserves;
- (d) promote the balanced development of state lands and protect the mineral reserve interest held in trust for the benefit of state schools; and
- (e) assist in providing much needed energy resources to the region.

History: En. Sec. 2, Ch. 578, L. 2001.

Compiler's Comments:

Effective Date: Section 9(1), Ch. 578, L. 2001, provided that this section is effective on passage and approval. Approved May 5, 2001.

Tab B

Nos. 05-35408, 05-35413, 0535586, 05-35587 (consolidated)

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

NORTHERN CHEYENNE TRIBE AND NATIVE ACTION, INC.,
Plaintiffs-Appellants/Cross-Appellees,
v.
GALE A. NORTON, *et al.*,
Defendants-Appellees.

NORTHERN PLAINS RESOURCE COUNCIL,
Plaintiffs-Appellants/Cross-Appellees,
v.
UNITED STATES BUREAU OF LAND MANAGEMENT, *et al.*,
Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MONTANA -- BILLINGS DIVISION

**DECLARATION OF PETER G. SCHOONMAKER IN SUPPORT OF
REPLY BRIEF OF DEFENDANT INTERVENORS-APPELLEES/CROSS-
APPELLANTS**

DECLARATION OF PETER G. SCHOONMAKER REGARDING
PINNACLE GAS RESOURCE'S ENVIRONMENTAL HARM
ASSOCIATED WITH THE MONTANA DISTRICT COURT'S ORDER AND INJUNCTION

Pursuant to 28 U.S.C. §1746, I, Peter G. Schoonmaker, declare the following:

1. My name is Peter G. Schoonmaker.
2. I am over 18 years of age and am competent to testify in this matter, and have personal knowledge of the facts set forth in this Declaration.
3. I reside in Sheridan, Wyoming.
4. I am the Chief Executive Officer of Pinnacle Gas Resources, Inc. ("Pinnacle"), a privately held company based in Sheridan, Wyoming.
5. I attended Denver University in the late 1970s and have over 15 years of experience in the energy industry, including experience in Coalbed Natural Gas development in the Powder River Basin in both Montana and Wyoming since its inception in 1996.
6. Prior to working at Pinnacle, I was an executive with U.S. Energy Corporation with responsibility for natural resource drilling operations, including the drilling and management of over 750 coalbed natural gas wells. I later served as President and Chief Operating Officer of Rocky Mountain Gas, Inc. (a subsidiary of U.S. Energy Corporation).
7. I have held my current position at Pinnacle since June 2003.

8. In my current position, I am responsible for Pinnacle's day-to-day operations, future growth and development, along with compliance with all regulatory affairs. Pinnacle is the Operator on Record for some 500 coalbed natural gas wells in the Powder River Basin.
9. I have practical experience in, and personal knowledge of, the matters discussed in this Declaration.
10. Pinnacle currently holds valid federal leases for oil and natural gas in the Powder River Basin area of Montana and Wyoming.
11. Pinnacle has invested over \$22 million dollars in coalbed natural gas development in Montana, and intends to continue investing millions of dollars in development of coalbed natural gas in Montana over the next ten years.

Coalbed methane wells for 2005 and 2006 are projected to be in excess of 500 annually.

12. Based on my understanding of the activities of Pinnacle and other companies developing coalbed methane in Montana's Powder River Basin, I believe the number of wells that would be approved by the Bureau of Land Management ("BLM") in 2005, were it not for the District Court's February 25, 2005 decision and April 5, 2005 injunction order, would be in excess of the annual maximum number of production-related applications for permits to drill ("APD") that the District Court's injunction limited to 500 total wells (including federal, state and private wells).
13. Pinnacle alone anticipated submitting plans of development ("PODs") for 482 coalbed methane wells in 2005. This includes its Coal Creek project consisting of 100 total wells (52 federal, 48 fee) and its Dietz Development project consisting of 382 wells (253 federal, 105

fee and 24 state). Pinnacle resubmitted its two PODs *without* the 305 federal wells, reducing the total number of wells in the two PODs to 177. The two PODs for these 177 wells already have Montana Board of Oil and Gas Conservation ("MBOGC") approval, subject to their approval of Environmental Assessments ("EAs"). Both EAs have been prepared in draft form and the staff of MBOGC are currently reviewing those NEPA documents.

14. In 2006, Pinnacle's wells alone would exceed the 500-well limit and geographical scope imposed by the injunction. Pinnacle is in the planning stages for three separate PODs that will be submitted in 2006. Two of those PODs will include approximately 400 federal wells. These Federal PODs are located in the same limited geographic area that is the subject of the District Court's injunction. A POD for Black Eagle Butte, which will include approximately 170 fee and state wells, and will be submitted in late 2005 or 2006. The Black Eagle Butte POD is outside the limited geographical area. Pinnacle has already conducted some site-specific work on these plans, and has been working closely with BLM.

There are significant environmental harms resulting from the District Court's injunction.

15. Pinnacle faces an increased risk of environmental harm based upon the constraints imposed by the District Court's injunction.
16. Given the checkerboard ownership of minerals within the Resource Area (see Attachment 1, Pinnacle map designating its lease holdings and development plans) and the 500 total well limit under the injunction, Pinnacle must develop its state and fee leases first and then return later to develop its federal leases. This two-staged development is an extremely inefficient way to develop coalbed methane from an environmental and resource perspective, as well as from an economic perspective. To minimize environmental impacts in the project area, one

should not artificially segregate out federal leases from the midst of this checkerboard land ownership pattern. Rather, contiguous leases should be developed at the same time to achieve the least disturbance and environmental impact.

17. Minimizing environmental impacts by developing in a large contiguous area is the state of Montana's preference when it approves PODs. A June 3, 2005 letter from BLM to MBOGC describes BLM's protest of Pinnacle's Dietz POD based on the following: (i) the drainage of federal minerals; (ii) well spacing should be based on a large contiguous area that includes fee, state, and federal lands; and (iii) well spacing should not be permanently designated at less than 640 acres for wells that have not yet been drilled. (See Attachment 2, Letter from BLM to MBOGC, June 3, 2005.)
18. There are a multitude of environmental impacts that directly resulting from this inefficient, two-staged development which Pinnacle is forced to undertake given the 500 total annual well limit imposed by the District Court's order. There are impacts on well spacing, mobilization, surface disturbance, produced water, landowners, and drainage.

Well spacing

19. Because of the checkerboard pattern of mineral ownership, the federal lands subject to coalbed methane development are completely interspersed with state and fee lands. Given the District Court's injunction, which limits the number of wells, Pinnacle must reduce spacing of wells from 160 acres/well to 80 acres/well to effectively depressure the coals. Because Pinnacle can only develop state and fee lands, it cannot develop a large contiguous acreage area. As a result, it must concentrate the same number of wells in a much smaller area to move enough water to create a zone of depressurization. Pinnacle's Coal Creek and

Dietz PODs must therefore employ 80-acre spacing; that spacing was approved by the Montana Oil and Gas Conservation. Using 80 acres/well spacing instead of 160 acres/well translates into a number of distinct environmental harms, with nearly twice as many roads, wells, infrastructure, disturbance, and produced water.

20. First, with almost twice as many wells and related infrastructure (i.e., roads, pipelines to convey the methane gas, utility lines). Eighty-acre well spacing therefore creates a much larger footprint and much more surface disturbance than 160-acre spacing.
21. Second, because 80-acre spacing results in twice the number of wells, it also produces roughly twice as much water over a longer period of time when compared to 160-acre spacing. Produced water was an area of particular concern to Plaintiffs and BLM in the Final Environmental Impact Statement. In fact, the District Court's injunction order imposed additional mitigation measures with regard to produced water, prohibiting (1) surface discharge of untreated water (except for the existing MPDES permit), (2) discharge of produced water into unlined impoundments unless already improved, and (3) discharge of produced water into on-drainage impoundments. Producing more water byproduct in the process of extracting the resource is an additional environmental impact, even with the court-imposed mitigation measures in place. Specifically, producing roughly twice as much water will require almost twice as many injection wells and reservoirs, and about double the surface area disturbance required for water management and treatment. As a result, Pinnacle faces additional environmental harm as a result of this spacing (as well as the expense associated with the additional mitigation measures required by the District Court to handle the produced water).

Two-staged development means multiple mobilizations, more surface disturbance, and longer rights-of-way.

22. Staged development means that surface disturbances are essentially doubled, particularly at Pinnacle's Coal Creek project. To develop coalbed methane requires the mobilization of hundreds of workers and hundreds of semi-loads of equipment. This mobilization effort is necessary to set up the wells, and excavate a right-of-way corridor for pipelines that move the methane, gas and utility lines, and roads to service the wells. There are a number of environmental and economic harms associated with mobilization: (1) damage to county, private, and state roads that are not built to withstand multiple trips by these heavy rigs and equipment; (2) disruption to private landowners; (3) disturbance to wildlife habitat and accidental wildlife deaths associated with increased traffic; and (4) increased dust levels and other air quality impacts (including exhaust and pollution associated with vehicular traffic). BLM has identified these impacts in the Final EIS.
23. The initial corridors will be built to accommodate the state and fee lands, not the federal lands. Given the risk that Pinnacle may never have an opportunity to develop on these federal leases, Pinnacle will not build excess capacity in its pipelines and gas and utility lines. There are environmental harms that result from the way these corridors will inevitably be developed under the District Court's order. One type of environmental harm results because these corridors will be longer than otherwise necessary since they have to go around the federal lease lands, making a larger footprint than if development included the federal lands from the start and occurred all at once. Once the federal leases are finally approved, Pinnacle will have to lengthen and widen the existing corridor so that it services the wells on federal lands.

24. Another significant environmental harm associated with staged development results because mobilization (and demobilization) must occur twice, not once. At some future date, presuming Pinnacle obtains approval to drill on its federal lease lands, it will have to mobilize all the people and equipment once again to expand the existing corridor (that includes pipelines, utilities, and gas lines) another 30 feet and lay a parallel track of pipelines, electricity, and gas lines. (For safety purposes, Pinnacle will increase the size of the right-of-way; it is too dangerous to excavate the prior lines to expand their capacity.) This will result in additional surface disturbance that would not otherwise occur if all leases were developed simultaneously.
25. The second stage that involves development on federal lands may not occur until after re-seeding and reclamation has already been completed along the corridor and well areas on state and private lands. That means that reclamation and re-seeding will have to be done twice in many areas.

Landowners

26. Montana surface landowners are particularly upset by lengthy, start and stop development. Mobilization and set-up is very disturbing to landowners: it involves hundreds of trucks hauling heavy equipment on and off their property every day, as well as lots of activity from vendors, contractors and operators. While the disruption to landowners is minimal once the wells are established, the start-up process disturbs landowners and can create friction between the operators and the landowners.
27. Some landowners have specifically complained to Pinnacle that they want development on their land started and completed as quickly as possible. Instead, however, the two-staged

development means that the short-term environmental and aesthetic harms to landowners will last much longer. These harms include having equipment on their land for extended periods of time, more wells than otherwise necessary, multiple mobilizations, and wildlife impacts.

Drainage

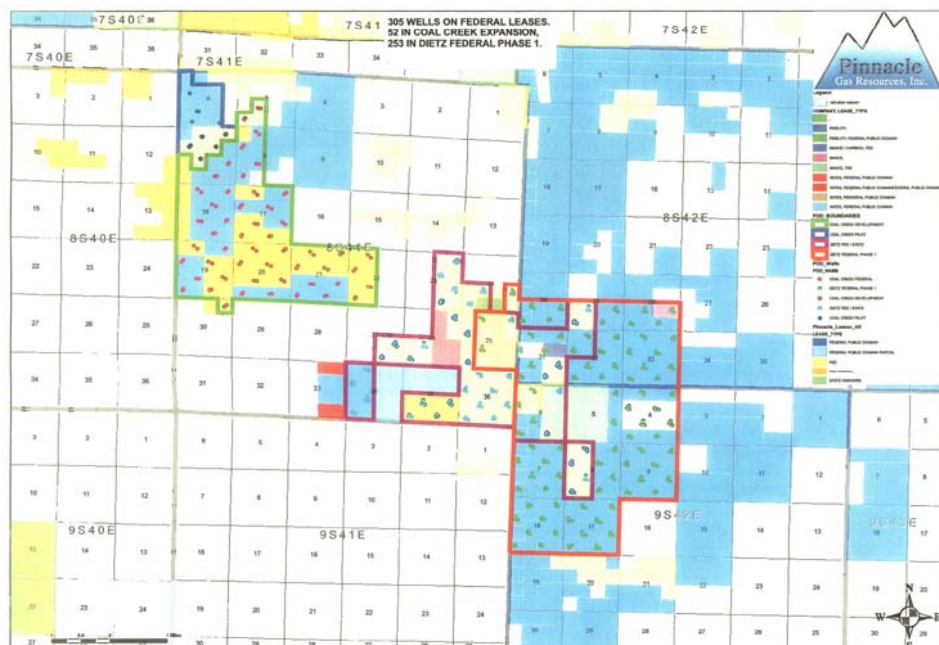
28. Enjoining development of federal leases also has a significant environmental harm to the natural resources that are the subject of these leases. Because adjacent state and private wells drain natural gas from federal leases, including Pinnacle's leases, Pinnacle will suffer a very direct harm to its interest in the physical environment.
29. There is already a significant amount of development occurring on private lands adjacent to Pinnacle's leases. Nance's Hanging Woman, and Fidelity's Coal Creek, Pond Creek and Badger Hills projects are currently or will drain Pinnacle's federal leases. This drainage diminishes the value of Pinnacle's federal leases and costs Pinnacle in revenues. This drainage is also costly to the federal, state, and county governments who lose tax revenue and royalty payments. (See my prior declaration dated June 21, 2005 describing this in detail, DI-SER78 to DI-SER90.)
30. Moreover, the methane gas underlying these leases is not being developed in the most efficient manner. When drainage occurs, the natural gas is not produced in a manner that, through placement of wells, will provide the greatest volume. I would anticipate that, as a result, some of the gas that would otherwise be available will not be produced.

I declare under penalty of perjury that the foregoing is true and correct.

Executed this 11 day of August, 2005.



Peter G. Schoonmaker



Attachment 2



United States Department of the Interior



In Reply
To:
3160 (922.JW)

June 3, 2005

Mr. Thomas Richmond
Montana Board of Oil and Gas Conservation
2535 St. John's Avenue
Billings, Montana 59102

Dear Mr. Richmond:

Pinnacle Gas Resources, Inc. (Pinnacle) has submitted an application (Docket No. 251-2005) to the Montana Board of Oil and Gas Conservation (MBOGC) for an order to delineate various lands in Big Horn County, Montana, as a field for production of coal bed natural gas from all coal bed zones from the surface to the base of the Fort Union Formation, and to establish field rules providing for 80-acre spacing units with 220-foot setbacks, and to approve its Dietz Project Plan of Development for coal bed natural gas exploration and development upon the subject lands. The subject lands are as follows:

T8S-R41E

Section 23:	E1/2
Section 24:	SW1/4
Section 25:	E1/2NE1/4, W1/2
Section 26:	E1/2NE1/4, SW1/4
Section 27	SE1/4
Section 34:	W1/2
Section 35:	S1/2
Section 36:	All

T8S-R42E
Section 29: SW1/4
Section 31: NW1/4, SE1/4

T9S-R42E
Section 6: Lots 1, 2, S1/2NE1/4, W1/2SE1/4
Section 8: W1/2

This application is scheduled to be heard before the MBOGC at a public hearing on June 9, 2005 as Docket Number 251-2005.

Pursuant to the Memorandum of Understanding between the Bureau of Land Management (BLM) and the MBOGC, this letter serves as written notification that the BLM protests this application.

The BLM protests Docket Number 251-2005 for the following reasons:

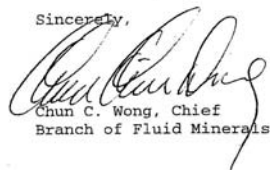
- 1) Federal mineral interests adjacent to and within the same governmental section as the subject lands will be adversely affected if the application is approved as proposed.

2) The relief requested involves proposed spacing units that fractionates spacing units and excludes Federal acreage. The BLM's position is that the requested spacing relief should apply to a large contiguous area and not just to Fee or State lands at the exclusion of Federal lands.

3) The "Statewide Rule" designates a standard spacing unit for gas wells as being 640 acres. The BLM's position is that a permanent spacing unit less than 640 acres should not be designated prior to a well being drilled. A proper spacing unit can only be determined after a well has been drilled, completed, and put on production for an adequate period of time so that an accurate engineering analysis can be performed.

If you have any questions regarding this letter, please contact Jack Wunder at (406) 896-5104.

Sincerely,



Chun C. Wong, Chief
Branch of Fluid Minerals

cc:

Miles City Field Office

John R. Lee, Attorney, Crowley, Haughey, Hanson, Toole & Dietrich P.L.L.P.

P.O. Box 2529, Billings, Montana 59103-2529

Keith Reeves, Pinnacle Gas Resources, One East Alger St., Suite 206,
Sheridan, WY 82801

Terri Perrigo, Montana Board of Oil and Gas Conservation,
1625 Eleventh Avenue, Helena, MT 59620-1601

Tab C